IT 14-0006 PLR 6/16/2014 Withholding – Other Rulings
Illinois income tax must be withheld from payments of wages or other items of income only if federal income tax is required to be withheld from those payments.

June 20, 2014

Re: Request for Letter Ruling, COMPANY A

Dear Xxxx:

This is in response to your letter dated January 29, 2014 in which you request a legal tax ruling whether certain transactions would subject COMPANY A to Illinois corporate income taxes. The Department's regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding against the Department, but only as to the taxpayer issued the ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of Department policy that apply, interpret or prescribe the tax laws and are not binding against the Department. See 2 Ill. Adm. Code 100.1200(b) and (c).

Review of your request for a Private Letter Ruling indicates that all information described in paragraphs 1 through 8 of subsection (b) of 2 Ill. Adm. Code 1200.110 is contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY A and the transaction described in your request. Issuance of this ruling is conditioned upon the understanding that COMPANY A and/or any related taxpayer(s) is not currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

Your letter states as follows:

> Below please find a request for letter ruling (the "Ruling Request") on behalf of COMPANY A (EIN XX-XXXXXXX) regarding the Illinois corporation income tax consequences of the proposed transaction described below. The relevant and necessary facts relating to the Ruling Request are set forth below along with a discussion of pertinent laws and regulations.
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> In summary, COMPANY A, a wholly-owned subsidiary of COMPANY B, is negotiating with an unrelated corporation ("Buyer") to sell the stock of its wholly-owned subsidiary COMPANY C for cash. COMPANY A and Buyer will make a joint election under Section 338(h)(10) of the Internal Revenue Code of 1986, as amended (the "Code"). Prior to the sale of the COMPANY C stock, COMPANY C will participate in an unrelated transaction with other COMP ANY B subsidiaries to restructure the legal ownership of those subsidiaries.
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> We respectfully request that you issue a ruling that: (1) for Illinois corporation income tax purposes, Illinois will follow the federal income tax treatment afforded to COMPANY C and COMPANY A as a result of the Section 338(h)(10) election, and COMPANY C will include any gain associated with the COMPANY C stock sale and Section 338(h)(10) election in its Illinois net income; and (2) consistent with the federal income tax treatment, a distribution made by COMPANY C prior to the COMPANY C stock sale will not cause COMPANY C to recognize gain for Illinois corporation income tax purposes.
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> **FACTS**
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> I. Corporate Structure

Prior to December 30, 2013, COMPANY B, a New Jersey corporation, owned all of the issued and outstanding stock of (i) COMPANY D, a Delaware corporation, and (ii) COMPANY A, a Pennsylvania corporation. COMPANY A owned all of the issued and outstanding stock of COMPANY C, a New York corporation. COMPANY C owned all of the issued and outstanding stock of COMPANY G, a New Jersey corporation, and all of the membership interests of COMPANY E, a Delaware limited liability company disregarded for federal income tax purposes. COMPANY G owned all of the membership interests of COMPANY F, a New Jersey limited liability company disregarded for federal income tax purposes and COMPANY H, a Delaware limited liability company disregarded for federal income tax purposes. The corporate structure is annexed as Exhibit A.

II. Restructuring

On December 30, 2013, COMPANY D merged with and into COMPANY E with COMPANY E surviving. COMPANY E will continue to be wholly-owned by COMPANY C after the merger. The transaction described in this paragraph is referred to herein as the "Restructuring." Each of the Proposed Transaction described below and the Restructuring would have been undertaken without regard to the other in the same form as described below and at approximately the same time.

III. Post Restructuring Corporate Structure

After the Restructuring, COMPANY B owns all of the issued and outstanding stock of COMPANY A. COMPANY A owns all of the issued and outstanding stock of COMPANY C. COMPANY C owns all of the issued and outstanding stock of COMPANY G and all of the membership interests of COMPANY E. COMPANY G owns all of the membership interests of COMPANY F and COMPANY H. The post Restructuring corporate structure is annexed as Exhibit B.

PROPOSED TRANSACTION

The following steps will occur to effectuate the proposed sale of COMPANY C stock to Buyer within a single taxable year of COMPANY C:

Step 1: COMPANY B, COMPANY A, COMPANY C, and Buyer will agree to undertake the transactions described in Steps 2 and 3 (in that order), and, following Step 3, to make the election described in Step 4 (the "Acquisition Agreement").

Step 2: COMPANY C will distribute all of its COMPANY G stock, its membership interests in COMPANY E, and certain other retained assets and liabilities (the "Distribution Assets") to COMPANY A (the "Distribution").[1]

Step 3: A subsidiary of Buyer will merge with and into COMPANY C with COMPANY C surviving or Buyer will purchase all of the issued and outstanding stock of COMPANY C (the "COMPANY C Sale"). COMPANY A will receive only cash in exchange for the sale of the COMPANY C stock, and Buyer will acquire all of the issued and outstanding stock of COMPANY C.

[1] Immediately prior to the Distribution, the COMPANY G stock will represent over 50 percent of the value of COMPANY C's combined assets.

Step 4: COMPANY A and Buyer will make a joint Section 338(h)(10) election with respect to the COMPANY C Sale (the "338(h)(10) Election").

Together, Steps 1 through 4 are referred to as the "Proposed Transaction." The post Proposed Transaction corporate structure is annexed as Exhibit C.

ISSUES

1. Whether the Illinois corporation income tax treatment of the 338(h)(10) Election conforms to the federal income tax treatment of the 338(h)(10) Election?

2. Whether the Distribution will be treated as part of the complete liquidation of COMPANY C pursuant to Sections 338(h)(10) and 332 and therefore tax-free for Illinois corporation income tax purposes?

RULINGS REQUESTED

1. For Illinois corporation income tax purposes, Illinois will follow the federal income tax treatment afforded to COMPANY C and COMPANY A as a result of the 338(h)(10) Election, and COMPANY C will include any gain associated with the COMPANY C Sale and 338(h)(10) Election in its Illinois net income.

2. Consistent with the federal income tax treatment of the Distribution, the Distribution will not cause COMPANY C to recognize gain for Illinois corporation income tax purposes.

REPRESENTATIONS

COMPANY B makes the following representations in connection with the Proposed Transaction:

1. COMPANY A and Buyer will satisfy all of the requirements in Section 338(h)(10) with respect to the COMPANY C Sale. Accordingly, the 338(h)(10) Election will be treated as a valid election under Section 338(h)(10) for federal income tax purposes.

2. The Distribution along with the deemed distribution of COMPANY C's assets that will result from the 338(h)(10) Election will be made pursuant to a formal plan of liquidation that will be adopted before the Distribution and COMPANY C Sale.

3. COMPANY A and Buyer will agree that COMPANY A will sell the COMPANY C stock to Buyer after the Distribution. The Acquisition Agreement will provide for the sale of the COMPANY C stock after the Distribution Assets have been distributed.

4. Buyer will covenant in the Acquisition Agreement that it will not undertake any action or engage in, or cause to be engaged in, any transaction that would jeopardize the validity of the 338(h)(10) Election.

5. The Proposed Transaction will not be undertaken, in whole or in part, in furtherance of any rationale for the Restructuring and the Restructuring will not be undertaken, in

whole or in part, in furtherance of any rationale for the Proposed Transaction. In addition, each of the Proposed Transaction and the Restructuring would have been undertaken without regard to the other in the same form and at approximately the same time.

6. There is no regulatory, legal, contractual, or economic compulsion or requirement that COMPANY B and its affiliates undertake the Restructuring, in whole or in part, as a condition or as a consequence of the Proposed Transaction, and vice versa.

DISCUSSION

Section 338(h)(10) Federal Income Treatment Overview

Section 338(h)(10) provides an election for the treatment of a qualified stock purchase as an asset purchase. The seller and buyer may make a joint election for the target under Section 338(h)(10). If this election is made, the target is deemed to have sold all of its assets to a new corporation owned by the buyer and then distributed the proceeds in complete liquidation, which is treated as a tax-free transaction under Section 332. This election also allows the seller to avoid the recognition of the gain on the sale of the target's stock. In the hands of the buyer, target will take a basis in its assets for tax purposes in an amount equal to the sum of the purchase price and the target's liabilities immediately after the transaction. The aggregate amount of basis is allocated to the assets according to their relative fair market values.

When a Section 338(h)(10) election is made, the distribution of unwanted assets by the target to its parent in connection with the sale by the parent corporation of all of the target's stock to the buyer is considered to be a part of the complete liquidation of the subsidiary under Section 338(h)(10) and not to be a current distribution under Section 301. *See* Treas. Reg. Section 1.338(h)(10)-1(e), Example (2). Example 2 of Treas. Reg. Section 1.338(h)(10)-1(e), as set forth below, supports this treatment of the distribution of unwanted assets as part of the complete liquidation of the subsidiary under Section 338(h)(10):

> Example (2). (i) S and T are solvent corporations. S owns all of the outstanding stock of T. S and P agree to undertake the following transaction: T will distribute half its assets to S, and S will assume half of T's liabilities. Then, P will purchase the stock of T from S. S and P will jointly make a section 338(h)(10) election with respect to the sale of T. The corporations then complete the transaction as agreed.
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> (ii) Under section 338(a), the assets present in T at the close of the acquisition date are deemed sold by old T to new T. Under paragraph (d)(4) of this section, the transactions described in paragraph (d) of this section are treated in the same manner as if they had actually occurred. Because S and P had agreed that, after T's actual distribution to S of part of its assets, S would sell T to P pursuant to an election under section 338(h)(10), and because paragraph (d)(4) of this section deems T subsequently to have transferred all its assets to its shareholder, T is deemed to have adopted a plan of complete liquidation under section 332. T's actual transfer of assets to S is treated as a distribution pursuant to that plan of complete liquidation.

The actual transfer by the target to its parent of part of its assets along with the deemed transfer of its remaining assets should be considered to be a complete liquidation if: (1) the actual and deemed distributions are made pursuant to a formal plan of liquidation that is adopted before the actual distribution and stock sale; (2) seller and buyer agree that seller will sell the target stock to buyer after target's actual distribution of the unwanted assets; and (3) seller and buyer agree to jointly make an election under Section 338(h)(10). *See* Treas. Reg. Sections 1.338(h)(10)-1(e), Example (2); 1.338(h)(10)-1(d)(4).

Conformity to Section 338(h)(10)

Taxable income, which is the starting point for computing Illinois corporation income tax, is ". . . taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code." 35 ILCS Section 5/203(e)(1). There is no provision in Illinois law that eliminates the effects of an election under Section 338(h)(10), and the Illinois Department of Revenue ("Department") has previously issued informal guidance stating that "Illinois does conform to the federal treatment and rules attending an IRC section 338(h)(10) election." Ill. Dept. Rev., Gen. Info. Ltr. No. IT 01-0043-GIL (May 2, 2001). Moreover, in setting forth the definition of "corporation" for Illinois corporation income tax purposes, Illinois Administrative Code Section 100.9750(b)(2)(B) recognizes the Section 338 fiction, providing that:

> A corporation that is treated as two separate corporations (as a corporation that has sold all of its assets and as a new corporation that has purchased all of the assets) pursuant to 26 USC 338 is similarly treated as two separate corporations, one in existence before the 26 USC 338 transaction and one in existence subsequent to the transaction, for all purposes of the IITA [Illinois Income Tax Act].

Accordingly, pursuant to the 338(h)(10) Election and in accordance with the federal income tax treatment of such election, COMPANY A, as the selling corporation, should not recognize gain on the COMPANY C Sale for Illinois corporation income tax purposes, and COMPANY C, as the target corporation, should recognize any related gain for Illinois corporation income tax purposes and report and include any such gain in its computation of Illinois net income

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Treatment of the Distribution

For the reasons discussed above, for federal income tax purposes, the Distribution is considered to be made pursuant to the complete, tax-free liquidation of COMPANY C pursuant to Sections 338(h)(10) and 332. *See* Treas. Reg. Section 1.338(h)(10)-1(e), Example (2). Accordingly, the Distribution is a tax-free transaction for federal income tax purposes, and COMPANY C should not recognize any gain as a result of the Distribution for federal income tax purposes.

With respect to the Distribution, Illinois has issued an Advisory Opinion that discusses the treatment of unwanted assets distributed in connection with a Section 338(h)(10) transaction, stating:

> . . . the Illinois income tax consequences of the transfer of Unwanted Assets [distributed pursuant to a Section 338(h)(10) election] is determined by the Section 338 election. Gain or loss on the transfer [of the Unwanted Assets]

> will be recognized or excluded [from Illinois net income] to the same extent as recognized or excluded in the computation of federal taxable income. . . .
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> Ill. Dept. Rev. Gen. Info. Ltr. No. IT 01-0012-GIL (February 13, 2001).

Because the Distribution is a tax-free transaction for federal income tax purposes, it should also be a tax-free transaction for Illinois corporate income tax purposes. *Id.* Thus, for Illinois corporate income tax purposes, COMPANY C should not recognize any gain as a result of the Distribution.

PROCEDURAL STATEMENTS

The Department is currently conducting corporation income tax audits for COMPANY B, COMPANY A, and COMPANY C for tax years 2009 and 2010. The Proposed Transaction is expected to take place in 2014; therefore, the tax periods at issue will likely be COMPANY A's and COMPANY C's respective 2014 calendar tax years. To the best of the knowledge of Scott Brandman, as COMPANY A's representative, and COMPANY A, the Department has not previously ruled on the same or a similar issue for COMPANY A or a predecessor, and neither COMPANY A nor any of its representatives have previously submitted the same or a similar issue to the Department but withdrew it before a letter ruling was issued. Further, neither COMPANY A nor COMPANY A's representative have located any authorities that are contrary to the conclusions stated herein.

Exhibit A

CHART

Exhibit B

CHART

Exhibit C

CHART

RULING

Conformity to Section 338(h)(10)

Section 203(b)(1) of the IITA provides that Illinois base income is an amount equal to the taxpayer's taxable income with certain modifications outlined in paragraph 2. 35 ILCS 5/203(b)(1). Section 203(e)(1) provides that taxable income is the amount of taxable income reportable for federal purposes under the provisions of the I.R.C. 35 ILCS 5/203(e)(1). Section 203(h) provides that no modification shall be made to taxable income unless expressly provided in Section 203. The analysis must begin, therefore, with the I.R.C. to determine whether the Section 338(h)(10) capital gain is included in the separate federal taxable income of COMPANY A and COMPANY C.

Section 338 of the Internal Revenue Code (I.R.C.) provides in relevant part:

> Sec. 338. Certain stock purchases treated as asset acquisition.
>
> (a) General rule. For purposes of this subtitle, if a purchasing corporation makes an election under this section (or is treated under subsection (e) as having made such election), then, in the case of any qualified stock purchase, the target corporation –

(1) shall be treated as having sold all of its assets at the close of the acquisition date at fair market value in a single transaction, and
(2) shall be treated as a new corporation which purchased all of the assets referred to in paragraph (1) as of the beginning of the day after the acquisition date 26 U.S.C. 338(a).

Section I.R.C. §338(h)(10) provides as follows:

(10) Elective recognition of gain or loss by target corporation, together with nonrecognition of gain or loss on stock sold by selling consolidation group.
(A) In general. Under regulations prescribed by the Secretary, an election may be made under which if –
(i) the target corporation was, before the transaction, a member of the selling consolidated group, and
(ii) *The target corporation recognizes gain or loss with respect to the transaction as if it sold all of its assets in a single transaction*, then the target corporation shall be treated as a member of the selling consolidated group with respect to such sale, and (to the extent provided in regulations) no gain or loss will be recognized on stock sold or exchanged in the transaction by members of the selling consolidated group. (emphasis added)

Generally, a Section 338 election provides that the selling corporation recognizes gain on the sale of stock and the target company recognizes gain on the sale of assets. Since both entities recognize gain under these circumstances, many taxpayers look to subsection (h)(10) of Section 338 which provides that no gain or loss will be recognized on stock sold or exchanged in the transaction by members of the selling consolidated group if the target corporation recognizes gain or loss with respect to the transaction as if it sold all of its assets in a single transaction.

Treatment of Distribution and Sale

Section 201 of the Illinois Income Tax Act ("IITA"), 35 ILCS 5/101 et seq, imposes a tax measured by net income "on every individual, corporation, trust and estate … on the privilege of earning or receiving income in or as a resident of this State. Such tax shall be in addition to all other occupational or privilege taxes imposed by this State or by any municipal corporation or political subdivision thereof."

The computation of a corporation's net income for Illinois income tax purposes begins with the taxpayer's taxable income, as properly computed for federal income tax purposes. Only those modifications expressly provided in IITA Section 203(b)(2) are then made to taxable income to compute base income. There is no provision in IITA Section 203(b)(2) that would modify the effects on taxable income resulting from a Section 338(h)(10) election. Accordingly, any sum properly excluded or deducted from income for federal purposes prior to the determination of base taxable income as the result of a Section 338(h)(10) election is effectively excluded from income for Illinois' purposes. Likewise, any sum required to be included in taxable income for federal purposes prior to the determination of taxable income as the result of a Section 338(h)(10) election is effectively included in base income for Illinois' income tax purposes.

Accordingly, if COMPANY C is not required to recognize gain as a result of the Distribution for federal income tax purposes, then COMPANY C will not recognize gain for Illinois income tax purposes. Furthermore, if COMPANY C is required to recognize any gain associated with the COMPANY C sale for federal income tax purposes, it will also be required to do so for Illinois income tax purposes. Similarly, if COMPANY A is not taxable on the sale of COMPANY C stock for federal income tax purposes, it will not be taxable on the sale of COMPANY C stock for Illinois income tax purposes.

This ruling shall only bind the Department for the taxable year of COMPANY A that includes the sale of COMPANY C. The facts upon which this ruling is based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling. If you have any further questions, you may contact me at (217) 524-7580.

Sincerely,

Brian L. Stocker
Chairman, PLR Committee (Income Tax)